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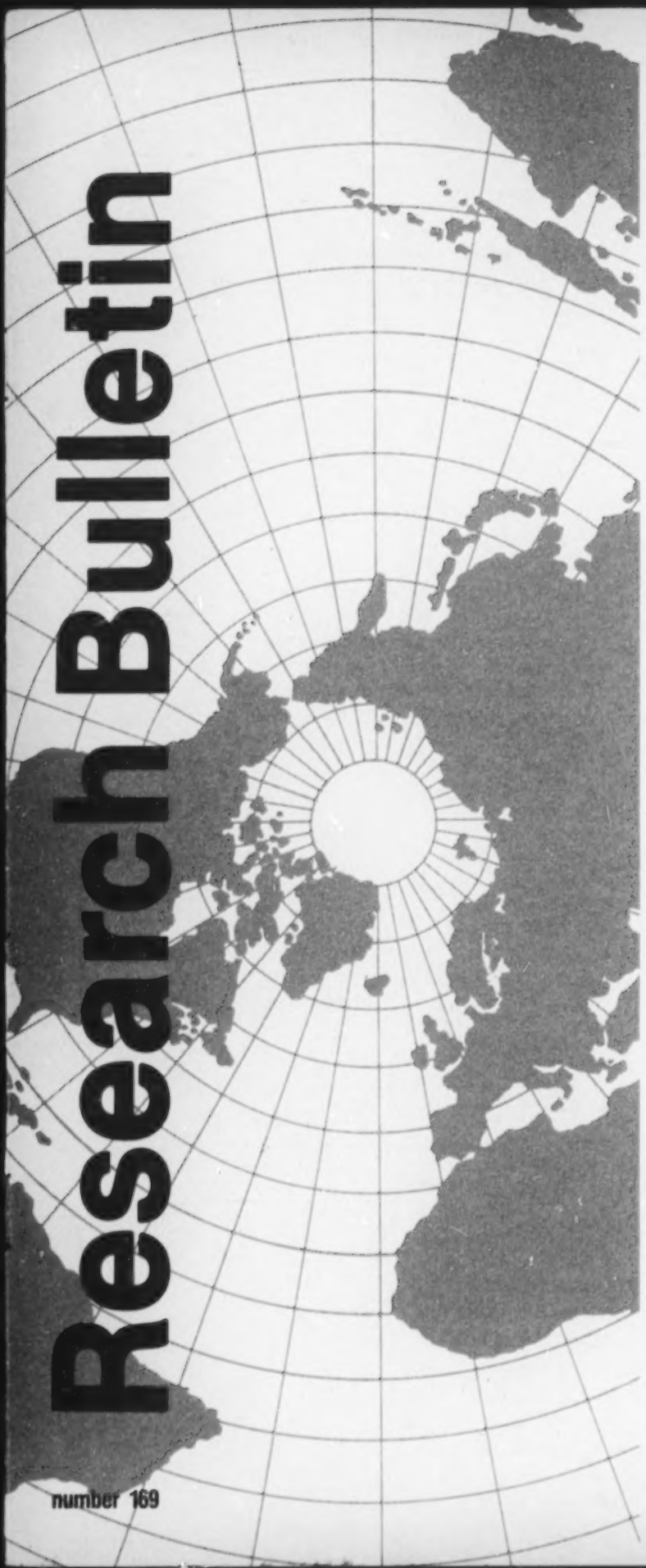

Research Bulletin

1985 International Economic Outlook

Views of U.S. Corporate Planners

by John Hein

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"Between now and the end of next year, important differences in developments among the different regions of the OECD economy are likely to continue," the Organization for Economic Cooperation and Development, which encompasses the 24 major industrial countries, noted in its semiannual *Economic Outlook* this past July. "The probable outcome for the United States, on present policies, is considered to be a slowing of the expansion . . . . In Japan, too, the period of fastest expansion may already be passed, but the domestic recovery there, although modest, could be more sustained . . . . In Europe, where the recovery started late, it remains fragile and appears unlikely to accelerate to a rate that would bring about a significant reduction in the level of unemployment by end-1985."

Against the background of this official evaluation, shown in greater detail in Table 1, The Conference Board asked economists, planners and analysts in U.S. private industry to submit their own views regarding the economic outlook abroad for 1985. As in previous years, the panel members were asked for their assessment of economic prospects in the countries "that are important to your company's foreign operations or on which you normally gather information." The following report, the ninth in this series, is based on the replies received from respondents in twelve major business organizations. Eight of these are among the two hundred largest U.S. industrial corporations as listed by *Fortune*; four are prominent in the financial and transportation sectors.

Most of the data and the qualitative assessments that were submitted were originally prepared for internal corporate use, and generally reflect the companies' major areas of activity, both geographically and in terms of products. Moreover, the data merely indicate the ranges within which certain estimates might fall in the near term or, as one respondent wrote in 1982, "what we regard as the most likely course through the company's planning period." Major corporations do continue to prepare and rely on such assessments—despite the *Wall Street Journal*'s remark this September that "the deepening skepticism about the usefulness of economic advice is leading some companies to drop in-house forecasting." In fact, one in-house economist who contributed to the current survey writes: "This year finds us a bit smug, since our previous year's forecasts seem pretty much on track. We have some longer-term concerns, but they are not overwhelming and are far enough in the future so that a prudent forecaster would not spend too much time stewing over them."

General Overview

The general tone that ran through the responses was set by one panelist: "Economic activity continues to show gradual gains in most industrial countries outside the United States, generally led by improved exports. The United States has served as the locomotive to the current global recovery, its strong import demand creating improved markets for both industrial and developing countries' exports. Led by growth of exports, augmented in some countries by investment spending, Europe's gradual pace of recovery showed signs of accelerating. In Canada, the rate of activity is slowing, paralleling the slowing pace of the U.S. recovery. Based on improved exports, Japan's output is growing at a stronger-than-expected 4.5 percent this year.

"The major countries of Latin America continue in recession, with growth constrained by their debt-service burden and excessive rates of inflation. The developing and emerging industrial countries of Asia, heavily dependent on exports, are participating in the generally improving global economy." Based on this somewhat cautious assess-

Table 1: Official Growth and Inflation Forecast (Percentage changes, annual rates)

	From Previous Year		From Previous Half Year		
	1984	1985	1984	1985	
			Second Half	First Half	Second Half
Growth of Real GNP					
United States	6.0	2.5	3.25	2.5	2.5
Canada	4.5	3.0	3.5	3.0	2.25
Japan	4.75	3.75	4.0	3.75	4.0
France	1.25	1.75	1.5	1.75	2.0
Germany	3.0	2.75	2.75	2.5	3.0
Italy	2.25	2.25	2.0	2.0	3.0
United Kingdom	2.5	2.25	3.5	2.0	2.0
All seven countries	4.5	2.75	3.0	2.5	2.75
Other OECD countries	2.75	2.5	2.5	2.5	2.5
Total OECD	4.25	2.75	3.0	2.5	2.5
GNP Deflators					
United States	4.0	4.75	4.5	5.0	5.0
Canada	4.5	5.0	4.5	5.5	5.0
Japan	1.5	2.0	1.75	2.0	2.5
France	8.0	6.0	6.75	6.0	5.5
Germany	2.75	3.0	2.5	3.0	3.0
Italy	11.25	8.25	9.5	8.25	7.25
United Kingdom	5.0	5.0	5.25	5.0	5.0
All seven countries	4.25	4.5	4.25	4.5	4.5
Other OECD countries	8.5	7.25	8.0	7.25	7.0
Total OECD	5.0	5.0	5.0	5.0	5.0

Source: Organization for Economic Cooperation and Development, *Economic Outlook*, July, 1984.

ment, this analyst offers the following forecast for real GNP growth for the world's major regions:

	1984	1985
United States	7.1%	4.2%
Canada	4.5	2.8
Europe	1.9	1.9
Latin America	–1.5	0.1
Asia–Pacific	4.9	4.5

A second respondent provides a somewhat broader picture that included both a backward glance and a look beyond 1985: "The accompanying table reveals how absolutely grim the five years which ended in 1983 were for all major areas. Even when the recovery year of 1983 is factored in, industrial production had advanced barely at all from 1978 levels, except in Asia. The second revelation of the table is how much better we expect the next five years to be. This does not imply that we forecast an end to all future recessions. But we do not expect the next five years to include more than nine to twelve months of bad times, in contrast to the very atypical twenty-four to thirty-six months of bad news that gripped the world economy during 1978–83."

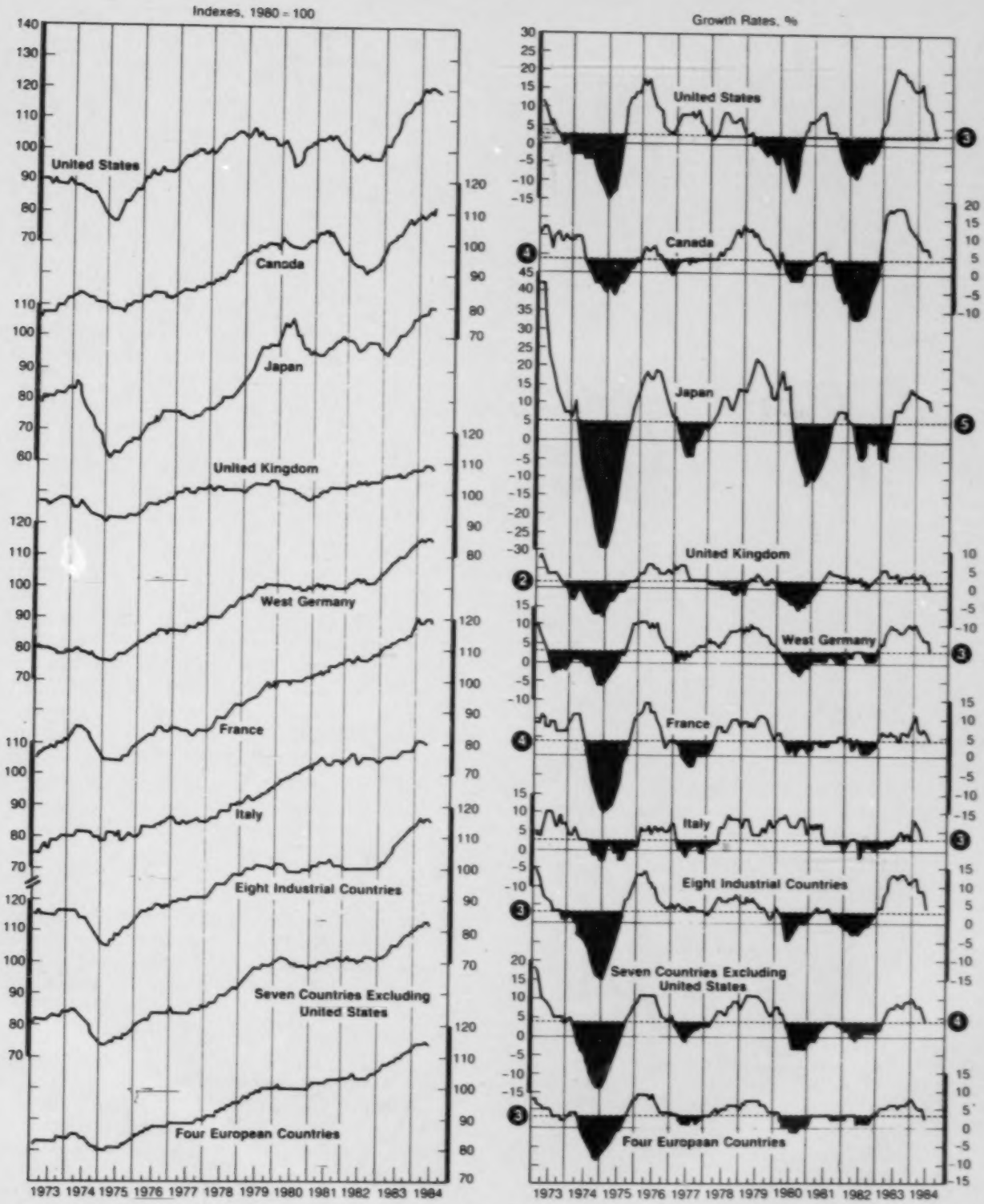
	Industrial Production (Average annual change, in percent)			
			(Estimated)	
	1978–83	1983	1984	1984–1989
United States	0.3%	6.4%	11.3%	4.5%
Europe	–0.1	0.4	2.5	2.3
Asia	4.6	7.0	13.8	5.9
Americas	1.9	–0.8	1.8	2.2

The crucial role of the United States is stressed by another panelist: "The recovery in most countries has been fueled by exports to the United States, and the outlook for 1985 thus depends in large measure on the growth of our domestic economy and the strength of the dollar. Since neither is likely to be as strong in 1985 as in 1984, our major trading partners will have to depend on uncertain increases in internal demand to offset the slower growth of exports."

Still, comments a fourth respondent: "At this juncture in the business cycle, it is premature to forecast another recession in Europe in 1985. While policy decisions in the last half of the year could prove overly restrictive, leading indicators and recent policy changes suggest continued overall expansion at a lower growth rate in 1985, relative to 1984, as the recovery matures."

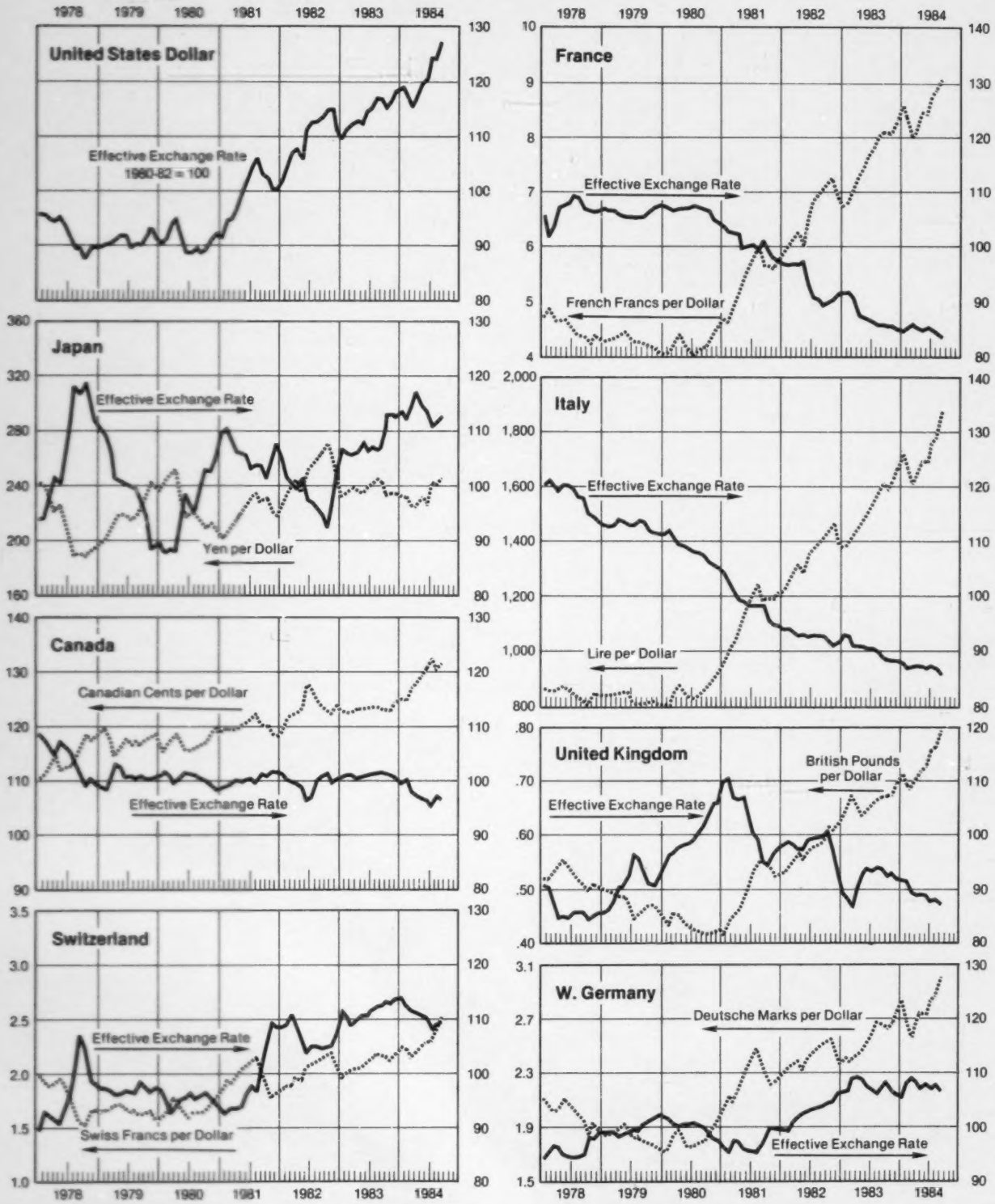
The relative strength of activity in the six major industrial countries outside the United States was confirmed by The Conference Board's *International Economic Scoreboard*, which noted in August that the combined index of leading indicators for those countries was rising faster than the U.S. index for the first time since the current recovery began. "The U.S. rate has slowed to five percent, while the six-country rate is seven percent. Japan, with an 11-percent growth rate is the front-runner, and the leading indexes for France, Germany and Italy are also rising faster than the U.S. index." These rates (which are annualized ratios of the latest month's index to the average index over the preceding twelve months) as well as the leading indexes themselves are shown in Chart 1.

Chart 1: Leading Business Cycle Indexes



Note: Horizontal dash lines are average growth rates for 1969-79 in the index and in real GNP.
Source: The Conference Board

Chart 2: Foreign Exchange Rates



Note: Nominal Effective Exchange Rates. Index numbers 1980-82 = 100. Each index shows a currency's trade-weighted appreciation or depreciation measured against fifteen other major currencies using averages of daily noon spot exchange rates in New York and bilateral trade weights based on 1980 trade in manufactures.

Source: Morgan Guaranty Trust Co.

The Role of the Dollar

The strength of the dollar vis-à-vis other major currencies (shown in Chart 2) plays an important part in virtually all respondents' outlooks for the coming year. It is worth recalling that in last year's survey the panel generally had predicted that the dollar would remain strong throughout 1984. (Examples: "We are talking about a currency which the sheer weight of numbers places in a category by itself"; and "The dollar is unlikely to face any devaluation from its current level in 1984.") This had been in sharp contrast to the view expressed by some government officials and several publications that a deteriorating trade and current-account balance eventually would sink the dollar "of its own weight."

This issue is taken up by one of this year's panel members: "The burgeoning U.S. trade deficit (expected to reach some $120 billion) with an associated current-account deficit (estimated at near $90 billion) would normally exert considerable downward pressure on the dollar's value. However, real short-term interest rates in the United States have risen further in recent months and are currently 3 to 5 percentage points above those of other key countries. This substantial disparity in real interest rates continues to generate global demand for dollars and is one of the primary factors behind the exceptionally strong dollar. Until there is a significant decline in real interest rates in the United States relative to other major countries, any depreciation of the dollar will probably be quite limited."

Another panelist adds a further dimension: "More than ever before, the decisions of international investors reflect their judgment about the economic outlook of various countries and their chances of mastering the persistently serious problems of recent years. The foreign-exchange markets have begun to take into consideration a wide spectrum of factors relating to the different countries' economies rather than the traditionally monitored variables, such as interest differentials and the balance of payments."

Any correction in the dollar's exchange rate in the near future is believed to be gradual at best. "The key word," one contributor writes, "is 'gradual,' acknowledging the fact that the timing of the exchange market's response to the winding down of the business cycle is by no means guaranteed. Analysts have been calling for the dollar's retreat since early 1983. At this point, there is much more consensus on a downward correction of the dollar than on its magnitude. For planning purposes, we are looking for a nearly 10-percent depreciation of the dollar against the D-mark and approximately 13 percent against the yen by 1986."

The adverse effects of a strong dollar on corporate activity and performance do not go unnoticed by an analyst with a chemical company: "The U.S. dollar could remain relatively strong over the remainder of the decade, given continuing high U.S. budget deficits and double-digit prime interest rates. A strong dollar thus cuts into earnings per share when foreign profits are translated into dollars."

Comments another contributor from a machinery producer: "The high value of the dollar has forced us to go abroad to manufacture and survive in foreign markets, and is leading us to bring that material back into the United States. The 'cost' to the United States will linger for a generation or more. Perhaps it simply has accelerated a structural trend. I doubt that 5 percent of Americans understand the tremendous structural impact this is having on 'known technology' industries. We have moved operations abroad and gone into joint ventures that we would never have considered otherwise. Moreover, the local talent in foreign countries has grown to the point where we do not use Americans abroad. This arrangement works and our costs are far lower."

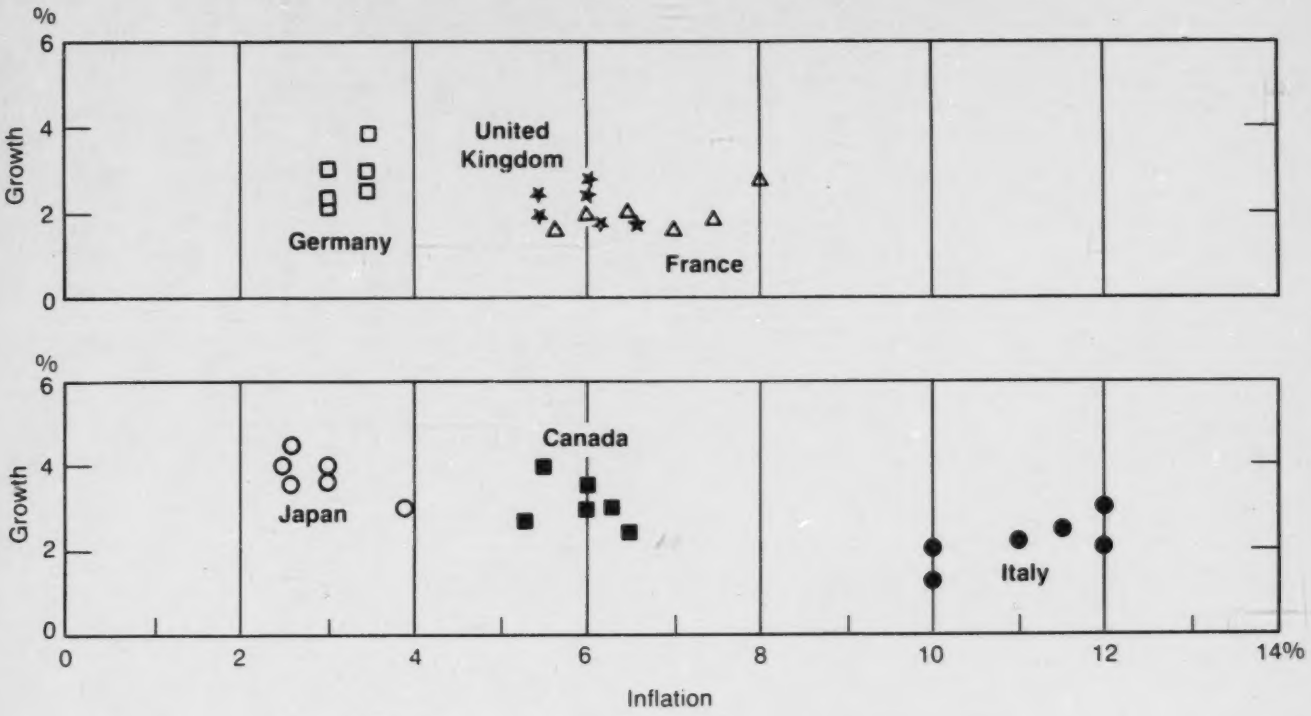
One panel member recalls that the election of Ronald Reagan in 1980 "meant that, for the first time in more than a decade, international capital was paid very generously for investing in dollars, and was comfortable doing so. But how long can this situation last? In theory, I suppose, it could continue for years. For example, the Canadian dollar was at a premium over the U.S. dollar for decades after World War II, in large part thanks to massive and continuing capital inflows from the United States—until the diminution of this capital flow sent the Canadian dollar to a discount. In practice, I'm convinced that this inherently unhealthy situation cannot last: Capital cannot indefinitely be paid so generously for doing nothing, for rolling over T-bills risklessly. Trade and current-account deficits cannot expand indefinitely without bringing about a market reaction both at home and abroad among affected industries and their workers, as well as affecting our ability to service debt and the desire of others to lend to us. Rickety debtor-nation balance sheets cannot be shored up indefinitely by accounting and linguistic gymnastics while interest costs keep rising."

Major Industrial Countries

This section presents the views of the panelists on the outlook for the six major industrial countries outside the United States. Each country section is prefaced by a brief quotation from the "official" outlook of the OECD, released this July. This technique serves to highlight the often diverse—and at times even offbeat—concerns of the panel members regarding individual countries.

The panel's assessment of the outlook for the six countries pointed, of course, in the same general direction as the OECD's outlook, although views differed as to the actual growth and inflation rates foreseen for 1985. Some of these projections are shown in Chart 3, in order to illustrate the range of the "most likely course" anticipated.

Chart 3: **Growth and Inflation in Six Countries, Forecasts for 1985**



Observations represent forecasts for growth and inflation rates in 1985 submitted by individual panelists

Canada

"As in the United States, the overall shape of the recovery has largely conformed with average pre-1983 experience . . . . A prospective slowing of domestic demand, which would be aggravated by a further rise in interest rates abroad, highlights the importance of export markets at this juncture for sustaining the upswing and thereby inducing business investment as capacity utilization rises."

OECD Economic Outlook

The close connection between economic activity in Canada and the United States invariably continues to color the statements of both Canadian officials and the members of The Conference Board panel. Thus, Gerald K. Bouey, Governor of the Bank of Canada, remarked in June that events in the United States had been the main source of pressures in Canadian financial and exchange markets. He said: "I would not want this emphasis on the United States to obscure the very real issues facing Canadians over time. . . . However, because of the size and importance of the U.S. economy, the essential problem from a global perspective is the fiscal situation and prospects for the United States. Because of high interest rates, investment needed to ensure future growth in the world economy is being inhibited."

Similar concerns were voiced by the panelists—all of whom, it should be noted, prepared their comments before the September 4 election victory of the Conservative Party. "The Canadian recovery," one writes, "is losing some of the momentum built during 1983. Consumption spending is slowing to a more moderate pace, and business capital spending has shown little real growth since the recession trough. While exports have benefited from the strength of the U.S. recovery, the weakening of the Canadian dollar could result in slightly higher inflation for 1985."

Another comments: "The Canadian recession had been much deeper than those experienced by the other major countries; initially the recovery was also faster, assisted by an expansionary fiscal policy. Capital spending, however, remains very weak, held back by low utilization rates as well as by a serious lack of business confidence in future

growth prospects. Without a boost from government spending, overall investment would be lower still."

A third view is even more pessimistic: "Consumer and business confidence have faltered; the federal budget deficit is higher than that in the United States as a proportion of GNP; and expansion of the export sector, the main source of growth in recent quarters, will likely slow as the United States, with whom Canada does about 75 percent of its trading, experiences a deceleration in economic growth. With little likelihood of major inventory accumulation against a prime rate of 13.5 percent, with the recent drop in the Canadian dollar adding inflationary pressures, and with commodity prices off substantially since year-end, we believe GNP growth this year could be as little as 3.5 percent, and lower still in 1985."

Looking ahead to the impending election, another panelist sees reason for hope, both for Canadian business and for mending fences with the United States: "Either Turner or Mulroney will improve the outlook for business and the economy. Some likely changes: scrapping or severe weakening of the Foreign Investment Review Agency (FIRA); extensive modifications to the National Energy Program (NEP); and better trade relations with the United States. Changes have already started, but a new Prime Minister will accelerate them."

Japan

"Growth in 1984 is likely to be stronger than for a number of years . . . . Given increased rates of capacity utilization, much higher profits, and the continued wave of technological innovation, the recovery could well be sustained into 1985."

OECD Economic Outlook

Private commentators, including The Conference Board's panel, often underscore various unusual features of the Japanese economy. A major French bank noted earlier this year that the economic indicators for Japan suggested a privileged country, with an annual growth rate of around 3 percent, a trade surplus of over $20 billion, inflation running at 1.8 percent, and unemployment as low as 2.6 percent. "And yet the Japanese do not seem content . . . . Conventional macroeconomic indicators and technological performance are inadequate as pointers to Japan's future owing to the many peculiarities of this Asian country, often wrongly suggested as a model for Europe."

At the turn of the year, the Japan Economic Research Center had commented similarly (in its *Quarterly Forecast No. 55*) that "the realities of life are usually full of contradictions. The real substance of long-term problems stands out prominently. Savings to the magnitude of 8 trillion yen remain idle without being put to practical use. Also, there is an excess supply capacity to the extent of 10 trillion yen. Trade frictions are intensifying. As long as neither Japan nor the United States is willing to make any concessions in their respective positions, then there will be no changes in this trade structure: a deficit of $100 billion for the United States and a surplus of $45 billion for Japan" (projections for 1984).

Several problem areas for the Japanese economy surface in the panel's comments. "Japan is beginning to experience overcapacity in steel, shipbuilding, petrochemicals and textiles. Also, Japan is vulnerable from the growing war between Iran (from which Japan receives its oil) and Iraq, as well as from growing worldwide protectionist trends."

Another respondent notes: "The Japanese economy will face a difficult year in 1985 as growth shifts away from exports. A further challenge will come from the need to roll over an unusually large amount of government bonds; this may require the government to offer a higher, more internationally competitive interest rate. The recent agreement with the United States, which calls for an acceleration of the liberalization of Japan's financial markets, also implies rising domestic interest rates. Since Japanese companies are much more highly leveraged than those in other countries, this may lead to a significant slowdown in the growth of private investment."

Another respondent also comments on some implications of the Japanese interest rate level: "On external account, Japan's problem has been one of success. From a domestic point of view, however, the authorities would have preferred to reduce interest rates more quickly in order both to stimulate economic activity and to ease the cost of financing the public-sector deficit. But with Japan's current account moving into a large surplus, such action might have been interpreted as pursuing a 'cheap yen' policy—and that concern clearly has inhibited a reduction in interest rates."

France

"If present economic policy is pursued, further progress should be achieved in 1984–85. Given wage restraint and the expected slow rise in import prices, inflation could be brought down in 1985 to the OECD average, compared with the differential of nearly four points in 1983. However, this can be achieved only through sharply curbed domestic demand and, probably, a substantial deterioration in labor market conditions. The various existing schemes to reduce unemployment will cease producing additional effects next year. If these are not supplemented, the unemployment rate will probably rise rapidly during the forecast period, perhaps to almost 11 percent by year-end 1985."

OECD Economic Outlook

The Mitterand government remains determined to modernize the state-owned sector—which is now estimated to comprise perhaps as much as half of all French business activity—and to make it more profitable and more competitive, even at the risk of higher unemployment. Yet, this program would certainly take longer than the political timetable allows: Parliamentary elections are due in 1986. While opinion polls in France have shown that the current austerity program is highly unpopular, some European observers have detected certain improvements in the French economy, including a slowing of inflation, a reduction in the trade deficit, and better financial results for some nationalized companies. The austerity budget introduced in mid-September aims at consolidating these improvements.

The Conference Board's panel proved to be almost equally divided between optimistic and gloomy views. "We continue to believe that France's economic recovery remains on track," one panelist wrote. "Following positive real GNP growth in 1983 of 0.9 percent, we now believe that 1.5 to 2-percent growth can be achieved this year and next. In our view, it is still too early to gauge the effect of Germany's shorter workweek on French unions."

Another respondent elaborates on this favorable scenario: "Signs are appearing that point to a better outlook for 1985. The government expects to continue curtailing its expenditures to keep the budget deficit below a targeted ceiling of 3 percent of gross domestic product. In the private sector, export sales have already generated a recovery in profits, leading to a sharp upward revision in business-investment plans. In addition, the government has promised a one percentage point cut in personal income-tax rates, which would bolster disposable income. As ongoing progress in reducing inflation buoys confidence, this boost to income could encourage spending and bring added investment activity."

A somewhat contrary view is expressed by another panel member: "The proposed 1985 fiscal stance indicates another year of weak (1 to 2 percent) economic growth. Having made the U-turn from fiscal expansion to austerity, the government's guidelines for the 1985 budget call for another year of restrictive fiscal policy. Preliminary government-expenditure ceilings call for a 10 percent (before inflation) cut in government capital spending, as well as lesser cuts in current spending. These spending reductions will be used to finance tax cuts.

"With parliamentary elections coming in 1986, the government may find it difficult to carry out another year of austerity. Its popularity is low and social tensions are high. Gross investment has been depressed and will provide only a moderate economic stimulus in 1984–1985. About half of total gross investment is construction. Housing starts are at a record low, due to depressed real incomes and adverse social legislation that have reduced residential investment incentives. Public construction is not likely to escape the planned 10-percent cut in government capital spending next year."

A slightly different aspect is discussed by a fourth respondent, namely, France's "traditional vulnerability to imported inflation." He notes that in virtually all post-World War II "crises"—such as the Korean War, the Suez crisis of 1956, and the two oil-price increases of the 1970's—consumer prices in France always rose by more than those in the rest of the industrial world. However, he also finds an important difference between the earlier and the later parts of this entire period. From 1950 until the late 1960's, "sudden price flareups were followed by corresponding downturns. Since the first oil crisis, decreases have been smaller than increases. With this breeding ground for inflation, breaking the price-wage spiral represents no mean challenge for France today."

Germany

"The rise in the average growth rate since 1982 is attributable mainly to foreign demand, the contribution of the real foreign balance moving from an annual rate of more than minus 1 percent in early 1983 to more than plus 1 percent of GNP in 1985. With capacity utilization rising rapidly, machinery and equipment investment seems likely to gain momentum, but construction investment is forecast to decline in 1985, while the expansion of private consumer demand will remain dampened by the fiscal impact on disposable household incomes."

OECD Economic Outlook

Earlier this year, *The Economist* commented that German travelers visiting Britain in the early nineteenth century felt that Germany could never hope to emulate the British economic miracle of the industrial revolution. These days, by contrast, "a British traveler returning from Germany has to report that that country's postwar miracle, so resplendent in the 1960's and still impressive in the 1970's, seems to be fading." The analysis commented further on "a state of mind adverse to risk-taking," on the social safety net having become "a social hammock," and on businessmen reluctant to innovate.

Similar uncertainties color some of the replies of the panel members, all of which were drafted before German Finance Minister Stoltenberg announced continued fiscal austerity for 1985. As one writes: "The government has improved financial market conditions by reducing the public-sector deficit, but has also weakened the incentives to work and to invest by raising tax rates and social contributions. Much uncertainty attaches to the 1985 forecast because of the difficulty of anticipating future policy measures and exchange-rate developments. The timing of economic policy actions is especially hard to foresee. It is, therefore, difficult to predict when the damping elements will fade and real improvement take place."

"Germany has bounced back well from the recent metal workers' strike," a second respondent writes, "but longer-term problems remain. While the srike has not killed the recovery, it has set the stage for lower economic growth in 1985 and a more uncertain economic environment in the late 1980's. The higher costs resulting from the 38½-hour workweek will weaken investment incentives and reduce real GNP growth to 2 percent in 1985. Slower growth will worsen the unemployment situation. There will be some upward pressure on prices and we look for a 2.5 percent inflation rate this year, followed by 3 percent in 1985."

This Spring's strikes, the most severe labor action since 1978, also give pause to another respondent: "The confrontation was in direct contrast to the normally cooperative labor movement, and highlights labor's desire to find a solution to high unemployment. While most of the production lost during the strike can be made up in the coming months, the consequences are more difficult to assess in terms of eroded business and consumer confidence."

A fourth panel member expresses the belief that Chancellor Kohl's conservative government will generally maintain its "pro-business policies," but still remains pessimistic as to the near-term outlook: "By early 1985, quarter-to-quarter growth rates for the total economy will decrease. Such slower growth by early 1985 is largely due to two factors. First, after the initial recovery from a low base, quarter-to-quarter comparisons are from higher levels. Second, and more important, monetary policy has turned relatively more restrictive during the past six to nine months. The money supply has been virtually flat and the central bank's money creation has been quite a bit slower than during the corresponding quarters of 1983. Interest rates have not moved up much this year because of reduced public-sector borrowing, although bank liquidity has decreased. There is ample room for monetary stimulus during the coming months without jeopardizing price stability, although exchange-rate effects must also be considered."

Italy

"The present recovery could prove to be relatively sustainable though moderate, with GNP growing by 2.25 percent a year in 1984 and 1985. The deceleration in inflation expected over the next eighteen months, to an 8 percent increase in 1985 for consumer prices and wages, represents a break from the trend of the 1970's. This forecast allows for the effects of measures taken in mid-February and mid-April introducing a ceiling on index-linked wage increases."

OECD Economic Outlook

Private observers do not generally share such a relatively rosy view of Italy's economic prospects, especially in the long run. In his company's newsletter (*Orientation*, October 1983), the chief economist of a major Italian insurance company discussed three major problems that required urgent solutions—rent control, which continued to distort the housing market; inequities in the tax system, which permitted widespread tax evasion, particularly by the self-employed; and the lopsided and overgenerous social-security system. He continued: "Politicians would be utterly wrong in dismissing the common man's uneasiness about these three problems, as well as his despondence over the malfunctioning . . . of many services, such as health, justice, public transport, etc. Not to mention the taxpayer's resentment for daily witnessing the expense and waste that take place at every level of the administration, with a profusion of initiatives of doubtful value, though labeled as resounding social or cultural aims."

Looking only as far ahead as 1985, the panel members likewise see reason to be concerned. "Italy's recovery, like that of France," one member writes, "has lagged those of the other major industrial countries, as growth has been held back by the need to bring inflation under control. Overall, the recovery in Italy is more fragile than elsewhere. Government borrowing needs have consistently exceeded targets; sustained recovery will depend on firmer control."

Another respondent notes: "Italy is experiencing a moderate economic recovery that will produce a real GNP growth close to 3 percent in 1984, slowing to 2.5 percent in 1985. Exports are the driving force behind the upturn, while investment growth is limping along at 3 percent per year. Inflation is decelerating rapidly (11 percent in 1984 as against 16 percent in 1983), but it has now reached a strong resistance point. Inflationary expectations are rising as wages increase faster than the government's inflation targets. We currently forecast a 10.5 percent inflation rate in 1984 and 1985. The size of the public debt (15 percent of GNP) continues to be Italy's major problem and the frequency of government changes prevents progress in this area."

Inflation and the effects of the budget deficit also are cited by another respondent: "Ten years of double-digit inflation have led economic agents to base their price and cost forecasts on high inflation expectations. Such behavior, which affects discussions about modifying the indexing of wages, is difficult to change. In addition, strong inflationary pressures are exerted by government expenditures and revenue—over and above the direct effects of inflation on the budget deficit. Strong fiscal drag at a time of sharp price increases has generated increasingly high pay claims. As a result, monetary policy is dominated by fiscal problems and the central bank has no alternative but to finance the deficit."

Another panelist, who also cites "the misallocation of resources caused by the budget deficit," shows some cautious optimism: "The short-term economic outlook continues to improve. Inflation is decreasing and the balance of payments will be in approximate equilibrium in

1984, after recording a large deficit during the recession." Still, he concludes, "Italy's 1984–1985 recovery will be moderate and dampened by conflicting monetary and fiscal policies. The choice between more inflation and deflationary fiscal policies has been pushed into 1985, but can't be postponed indefinitely."

United Kingdom

"The prospect for the next two years is for growth to remain in the two to three percent range, for inflation to stabilize around five percent, and for the current account of the balance of payments to remain in moderate surplus."

OECD Economic Outlook

It is not only British travelers returning from the Continent who feel that Britain's economic performance compares most favorably with that of Germany. Barclays Bank commented this Summer that the United Kingdom used to be described disparagingly as "the sick man of Europe." These days, it would probably be fair "to describe the whole of Europe as a hospital ward, the United Kingdom being seen as one of the patients showing better recovery prospects; and that erstwhile most robust of athletes, West Germany, showing worrying signs of relative weakness."

The panel's assessment of Britain's near-term prospects was generally upbeat. One respondent listed the following favorable factors, telegram-style:

- "Despite the miners' strike, business growth cycle remains good at 2.2 percent for 1984, and 2.0 percent for next year.
- "Unemployment remains high, at 12.7 percent, but should decline as industrial production growth, led by export growth, climbs.
- "Plant and equipment spending to increase as 34 percent of firms are operating at full capacity (as against only 23 percent in previous survey).
- "Consumer prices now stabilized at 5.5 percent rate."

Similar positive indications are reported by another panelist: "Investment, while strong since the end of 1983, still has not recovered to its previous peaks, but rising orders and good profits have boosted business optimism. Improved cash flow and a short-term stimulus from changes in corporate taxes are also energizing investment plans. At the same time, exports have responded strongly to the renewed competitiveness of the currency and reviving economic activity elsewhere. These factors could prolong the British recovery into 1985."

Comments a third respondent: "The economy will remain on an expansionary path in 1984–1985. Although the coal miners' strike is causing an indeterminate loss of output and disruption to the British economy, other key sectors are tracking satisfactorily. Gross fixed investment and exports are taking over as the driving forces to the economy."

A cautionary note is injected by one panel member, who feels that the favorable outcome generally foreseen for next year could easily be altered by a number of events: "Most important is the impact from the current high levels of strike activity, including workers in such vital areas as mining and transportation. The impact of these strikes cannot be fully assessed until settlements are reached. Those settlements and the recent plunge of the pound are likely to add to domestic inflationary pressures."

A similar note is struck by another panel member: "Putting aside the consumer sector, the outlook for the British economy is unexciting. The coal miners' and dock workers' strikes have only served to open the government-labor rift a bit further. Granted, we do not envision a repeat of the chaotic 1970's, when labor unrest brought down a government and played havoc with British financial markets. But the U.K.'s inability to chip away at the 10 to 12-percent unemployment level presages low industrial productivity growth for the near future." The strikes, another respondent notes, "could also have negative repercussions on inflation as a result of a worsening trade balance and a weaker pound sterling." (The dock workers ended their strike in mid-September, without winning any major concessions.)

Other Countries

This section presents selected comments by panelists on ten additional countries. Projections for these (plus some other) countries are given in Table 2.

"In **Argentina**, the Alfonsin administration continues to try to reconcile austerity measures needed to meet the approval of the International Monetary Fund with measures considered necessary to stimulate the economy. Growth in real GDP is forecast at 2 percent for both 1984 and 1985. Inflation, currently running at an annual rate of almost 600 percent, is expected to average over 500 percent for the full year 1984, but slow to 300 percent in 1985."

"In **Australia**, the favorable influence of the agricultural recovery has run its course and further economic stimulus will now have to come from the consumer, from higher government expenditure, and from investment, especially residential construction. Real GNP is forecast to grow by 5 percent in 1984, slowing to 2 percent in 1985. Private-sector capital spending remains the outstanding area of weakness, reflecting the world economic and investment outlook, high cost structures, and lackluster penetration of markets in growth areas, particularly in the Pacific Basin. The inflation rate is showing a substantial drop this year, with 6.5 percent expected, compared with 10.1 percent in 1983. Part of that decline, however, reflects the removal of medical costs from the index. For 1985, the rate is expected to increase to 7.5 percent."

Table 2: Selected Projections of GNP and Price Changes, 1985, for Smaller Industrial and Major Developing Economies
(Annual rates, in percent)

	1985/1984			1985/1984	
	Real GNP	*Consumer Prices*		*Real GNP*	*Consumer Prices*
Australia	2.0	7.5	Argentina	1.0	365.0
	2.5	6.0		2.0	300.0
Austria	2.8	5.0	Brazil	0.0	100.0
	3.0	4.5		2.0	194.0
Belgium	1.5	6.0	Hong Kong	5.0	8.0
	2.0	6.0		6.5	11.0
Netherlands	2.0	4.0	Korea	6.5	5.0
	3.0	3.0		7.0	7.0
Spain	2.7	8.5	Mexico	1.0	60.0
	1.5	10.0		5.0	55.0
Sweden	2.5	5.5	Taiwan	6.5	6.5
	2.5	7.5		7.0	4.5
Switzerland	2.5	2.5	Venezuela	0.0	32.0
	2.5	3.8		1.5	18.0

"Recent developments in the **Brazilian** economy have led many economists to state that the domestic situation was improving and that the recessive trend could be reversed soon. Even the government is now projecting a positive 1 percent GDP performance for this year. However, the true economic situation may not be as good as seen by the government and those economists. High inflation and disappointing GDP performance, quite possibly at minus 2 percent this year and zero next year, will prevent purchasing power from recovering. Thus, the domestic economy has not yet recovered from previous losses and will continue depressed in both 1984 and 1985."

"**Hong Kong** has been happily caught up by the positive phase of the world business cycle. Since the United States is Hong Kong's major market and consumer goods are the leading export category, the territory has benefited mightily. Also, since trade lives on finance and transportation, Hong Kong, having few rivals in either of these services, has been triply blessed. In summary, the present economic situation and the near-term outlook have to be characterized as far more promising than anyone could have hoped. Beware of any forecasts for the late 1990's, however (when the territory will revert to China). They literally would not be worth the paper they are printed on."

"**Koreans** are smiling these days and understandably so, since they are enjoying their best economic performance since 1978. Looking ahead, two phrases sum up our outlook—further economic transition and trade liberalization. To date, Korea's recovery has been broadly based, spreading from the relatively small construction and domestic consumption sectors to heavier industry and exports. To avoid being labeled 'another Japan,' Korea is promoting import liberalization. We expect very selected progress in dismantling trade barriers—just sufficient to keep trading partners' concerns, mainly those of the United States, at bay. Korea's current-account deficit should not suffer as a consequence and, in 1985–1986, it could actually be in balance."

"The **Mexican** economy is on an improving path, but inflation is still higher than targeted. In the first quarter, controlled prices for electricity, petroleum and basic foods were hiked. While further increases in those prices are unlikely this year, inflation continues to put pressure on the peso and to encourage capital flight. Moderate growth in capital formation is expected to begin later this year in the public sector, and in the private sector in 1985."

"In the **Netherlands**, three consecutive years of economic decline have forced the government to awaken to the sad reality that it can no longer afford the expensive social programs it has been implementing for years. Plans announced this Spring indicated a reduction in the budget deficit to 10.7 percent of GNP this year, from 11.5 percent in 1983. If the world expansion goes as well as we expect, the Dutch can look forward to several years of respectable economic growth. Rising world demand will spur further increases in exports. Private investment will continue to grow as the business sector sees profit margins increasing. Consumption will pick up eventually as the country's fiscal position improves."

"In the midst of a brighter economic picture, **Sweden** is beginning to feel a disquieting sense of déjà vu. In the late 1970's, the country was enjoying a strong economy, only to be knocked out by a surge in inflation. Economic indicators are pointed to a repeat performance for late

1984–1985. With exports still rising and a very low unemployment rate (2 to 3 percent), Sweden is suffering from a shortage of skilled labor to keep the growth pump primed. Result: A steady dose of wage inflation and a loss in international competitiveness. Further government restraint can, therefore, be expected in the medium term. Moreover, changes in the international economic mood become critical to the Swedish business outlook."

"Economic growth is accelerating in **Taiwan**, as exports and corporate profits are booming. Real GNP grew at a 12 percent annual rate in the first quarter, compared to a 7.1 percent rate for all of 1983. Growth rates of 9.1 and 8.8 are anticipated for calendar years 1984 and 1985. Government spending was cut for the first time in 30 years in the fiscal year ending June, 1984. The budget for the 1984–1985 fiscal year calls for an 11 percent spending increase."

"Domestic demand in **Venezuela** has been largely flat this year to date, owing to delays and swings in policy implementation. The exchange rate has fluctuated widely because of the multitiered system and speculation. Recent policy moves were a little more enlightened—an increase in the maximum interest rate should stimulate more lending. Public-sector interest arrearages have been reduced significantly since March, but private-sector arrearages remain in the $800–$1,000 million range. Growth is expected to improve slightly from minus 1 percent this year to plus 1 percent in 1985."

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